Available online at www.sciencedirect.com
ScienceDirect
Procedia - Social and Behavioral Sciences 156 (2014) 643 – 647
Procedia
Social and Behavioral Sciences

19th International Scientific Conference; Economics and Management 2014, ICEM 2014, 23-25 April 2014, Riga, Latvia

The analysis of factors influencing the write-off of goodwill

Alfreda Šapkauskienė[a]*, Šviesa Leitonienė[b]

[a, b] *Kaunas University of Technology, K. Donelaičio g. 73, LT-44029 Kaunas, Lithuania*

Abstract

Information related to goodwill is of great significance and of particular interest to users of financial statements. Accounting standards present a number of cases when goodwill has to be monitored due to a decrease in value and possibly written off. However, as the analysis of empirical research showed, the main problem is that the performance of monitoring due to a possible decline in goodwill provides company executives with an opportunity to manipulate this type of information, therefore, users of financial statements cannot always be sure whether the value of goodwill was properly adjusted and on what grounds this correction was made. Thus, the purpose of this article is to analyse factors determining the write-off of goodwill through the comparison of factors which are included in accounting standards and which can point to the decreased value of goodwill, and factors and causes which condition company's practical decisions on goodwill write-offs.

Peer-review under responsibility of the Kaunas University of Technology.
Keywords: Goodwill; impairment; accounting; IFRS; fair value.

1. Introduction

Goodwill has been a hot topic of discussion on a global scale. It is gaining importance as an element of financial statements and its relative portion forming the asset continues to increase. The greater its portion on the balance sheet, the more significant the examination of causes of its change. The inclusion of goodwill in financial statements and the existence of its amount (especially if it is of some value) attract the interest of investors, auditors and other users of financial statements.

* Corresponding author. Tel.: NA.
E-mail address: alfreda.sapkauskiene@ktu.lt

Peer-review under responsibility of the Kaunas University of Technology.
doi:10.1016/j.sbspro.2014.11.256

In addition, the nature of goodwill is still difficult to comprehend, hence, it is not easy to establish appropriate assessment methods of accounting for goodwill purposes (Abeysekera, 2012). In order to account for goodwill, companies, which prepare consolidated financial statements in accordance with the International Financial Reporting Standards for periods beginning from 1 January 2005, have to apply a goodwill impairment test which significantly changed the regulations of accounting for goodwill. Though it was anticipated that financial statements will correspond to economic realia and will become more transparent to users of financial statements as a result of the transition to fair value accounting, however, goodwill impairment tests provide an opportunity to manipulate this type of information.

The standards stipulate that goodwill must be tested for impairment once a year unless there is some indication that the value of goodwill can be declined. As a result of the factors which can reveal the possible value decrease, identification becomes a significant stage in the value determination process. The main problem is that when the annual amortization of goodwill is replaced with an unpredictable goodwill impairment test, the external users of financial statements find it difficult to identify when the value of goodwill declined and when it will be written off. Therefore, a great deal of recent scientific research focusing on the issue of goodwill write-offs seeks to disclose the main factors and causes which determine decision-making on goodwill write-offs.

The subject of the research is goodwill as an intangible asset acquired during a business merger.

The purpose of this article is to analyze factors determining the write-off of goodwill through the comparison of factors which are included in accounting standards and which point to the decreased value of goodwill, and factors and causes which condition company's practical decisions on goodwill write-offs.

2. Method

In order to find out what reasons and factors influence most of the goodwill write-off decisions, first of all a comparative analysis of the goodwill accounting regulations is performed, which includes International Financial Reporting Standards (IFRS), USA GAAP and Great Britain's FAS. The International Financial Reporting Standards are chosen, since these are most widely used in the world and due to the fact that based on a directive no. 1606/2002 by European Commission in 2002 companies, that quote their shares in the regulated markets within European Union must prepare consolidated reports based on IFRS for reporting periods starting from the 1st of January, 2005. The USA's GAAP and Great Britain's FAS were chosen for comparative purposes. The United States were chosen for several reasons. Most of the analysed researches in the area of goodwill are focused on the companies of USA which follow the USA's GAAP. Moreover, regulation of the goodwill accounting according to the IFRS is slightly similar to the generally accepted accounting principles of the USA, especially because that there has been a shift from the goodwill deprecation to the testing for impairment. Secondly, scientific researches that analysed reasons and factors causing the decisions for goodwill write-off are analysed. For the research of goodwill write-off the following methods were used: analysis of the scientific literature and systematization, as well as, comparative and grouping methods.

3. Results

The publishers of the accounting standards have provided a very minimal and incomprehensive list of reasons (36 IFRS paragraph 12, 142 FAS paragraph 28, 11 FAS paragraph 10), in which suggestions and examples for the analysis of goodwill impairment are provided (Ernst & Young, 2010) (see Table 1).

One of the most popular factors of research in the latest scientific studies is the influence of the executives to the goodwill write-off. It has been proved with scientific research that companies which have recently changed their executives are more inclined to write-off their goodwill in order to demonstrate better financial results in the later years of their management (Vichitsarawong, 2007, Zang, 2008, Lemans, 2010, Ramanna & Watts, 2011, Saastamoinen & Pajunen, 2012).

In addition to internal factors, the accounting standards distinguish external factors as well, which can influence the goodwill impairment. These factors are widely discussed in the scientific researches in order to determine whether they have any significant influence to the goodwill write-off (Ramanna & Watts 2008, Van de Poel, Maijorr, & Vanstraelen, 2009, Lemans, 2010, Camodeca & Almici, 2012, Jarva, 2012, Saastamoinen & Pajunen, 2012).

Table 1. Factors that cause goodwill write-off (according to the accounting standards)

Factors	IAS 36	USA FAS 142	GB FAS 11
Internal Factors			
Changes in senior management / Key personnel losses		x	x
Improper budgeting		x	
Changes in any value ratio (e.g. turnover) used to assess the fair value during the purchase			x
Probability of accountable entity's sale or rejection	x	x	x
Opportunity of a business contract with key providers and distributors		x	
Change of a company's name		x	
Unsuccessful management of an acquisition		x	
External Factors			
Changes in interest rates that impact discount rates	x		x
Unexpected/increased competition		x	x
Significant changes in business climate			x
Amendments of legal acts	x	x	x
Unfavourable actions of regulation		x	

The analysis of scientific literature has shown that in practice companies make decision to write-off their goodwill for many other reasons than the ones that are indicated in the accounting (see Figure 1). For example, the size of the company, i.e., bigger companies usually perform more business mergers and acquisitions, which leads to them having a bigger amount of goodwill in the balance, therefore there is a probability that the goodwill impairment losses can be proportionately higher (Zang, 2008, Ramanna & Watts 2008, Van de Poel et al., 2009, Lemans, 2010). Conversely to Vichitsarawong (2007) the research results have shown that there is no significant relation between the size of the company and goodwill write-offs.

Internal factors include highest level staff and financial factors that influence the goodwill write-off. For example, apart from the change of company's executives which is distinguished in accounting standards, the reputation of executives also influences the goodwill write-off (Ramanna & Watts, 2008), as well as, the behaviour of the executives and rewards, associated with financial results (Beatty & Weber, 2006, Ramanna & Watts, 2008). Results show that executives are not inclined to write-off the goodwill when it could diminish their rewards or damage their reputation, since as company's profitability declines the activity of its executive tends to be evaluated negatively.

Internal factors
- *Company characteristics*
  - Company size
  - Number of segments
- *Top management*
  - Change of executives
  - Reputation of executives
  - Salaties ad reards associated with results
- *Financial*
  - Amount of goodwill in the balance
  - Revenues management
  - Company's level of indebtedness
  - Company performance indicators

External factors
- *Economic*
  - GNP level
  - Unforeseen/increased competition

Figure 1. Factors determining goodwill write-offs revealed by companies

Also, scientific research reveals that goodwill write-off has a negative effect on financial results and usually causes negative reaction of investors which manifests itself as stock price decline (Escaffre & Sefsaf, 2010, Aquino, Rensel, Rensel, & Lee, 2011). At the time when accounting requirements are not clear and fully developed, companies start to behave selfishly, i.e., they begin to manipulate accounting data, manage revenues (Wines, Dagwell, & Windsor, 2007, Zang, 2008, Lhaopadchan, 2010, Brutting, 2011). Three such revenue management forms are distinguishable: stability of the revenue, revenue increasing procedures and revenue diminishing procedures (Onesti & Romano, 2012). The first case is explained by the fact that investors positively evaluate those companies, whose profits steadily grow year after year (Massoud & Raiborn, 2003). Therefore, when companies significantly exceed market expectations, companies tend to write-off goodwill and maintain their steady growth of profits (Van de Poel at al., 2009, Lemans, 2010). In the second case, when the level of companies' revenue is close to the point at which positive financial result can turn into negative, companies tend to forbear themselves from writing-off goodwill and choose to show positive result in their financial reports (Chambers & Finger, 2011). And in the third case, empirical studies showed that unprofitable companies are more likely to write-off their goodwill (Van de Poel et. al., 2009, Jordan & Clark, 2011, Lemans, 2010, Saastamoinen & Pajunen, 2012). Unlike Jahmani (2010), the research made has shown that there is no relevant connection between negative financial results and goodwill write-off.

Goodwill write-off is also commonly associated with the economic situation in the country. The research made by Camodeca and Almici (2012) has revealed that European banks which quote stocks in European stock exchange bureaus, within the period from 2006 to 2011 have written-off the most goodwill in 2008 when the financial crisis had the greatest impact. Goodwill write-offs matched the downward trens of the actual GNP.

Consequently, all provided examples influence to the goodwill write-off decisions. These results help to understand the motifs of companies' executives for making the goodwill write-off decision and determining the amount of goodwill impairment.

4. Discussion/Conclusions

The possibility to forecast the goodwill impairment based on the information provided in the financial reports is limited.

Accounting standards provide a list of factors which can signal the possible goodwill impairment, however, the performed analysis of the sources has shown that in practice goodwill write-offs are influenced by different factors.

The companies have interpreted the instructions of accounting standards poorly. The empirical analysis has shown that even though the analysed accounting standards indicate advice and recommendations regarding the circumstances that should be taken into account before determining the goodwill impairment, still, the major part of decisions for goodwill write-offs are determined by selfish interests of the executives and manipulations with accounting information.

References

Abeysekera, I. (2012). Measuring and recognizing the value of purchased goodwill: A note on market value measurement method. *Academy of Taiwan Business Management Review, 8,* 57-65.

Aquino, C., Rensel, A., Rensel, C., & Lee, T. (2011). The Impact of Goodwill on Stock Volatility. *Journal of International Finance and Economics, 11*, 31-37.

Beatty, A., & Weber, J. (2006). Accounting Discretion in Fair Value Estimates: An Examination of SFAS 142 Goodwill Impairment. *Journal of Accounting Research, 44,* 257-288.

Brutting, M. (2011). *Goodwill Impairment. Causes and Impact. Thesis of doctoral disertation: finance*. City University London.

Escaffre, L., & Sefsaf, R. (2010). *French market reaction to the announcement of goodwill impairment.* Working paper. University of Angers.

Camodeca, R., & Almici, A. (2012). The information content of goodwill impairment before and after Financial Crisis: evidence from European listed banks. 7th Annual Business Research Conference, London. Available at: www.wbiconpro.com.

Chambers, D., & Finger, C. (2011). Goodwill Non-Impairments. *The CPA journal, 81*, 38-41.

Ernst & Young (2010). Impairment accounting - the basics of IAS 36 Impairment of Assets.

Jahmani, Y., Dowling, W.A., & Torres, P.D. (2010). Goodwill Impairment: A New Window For Earnings Management. *Journal of Business & Economics Research, 8,* 19-24.

Jarva, H. (2012). Economic consequences of SFAS 142 goodwill write-offs. Available at SSRN: http://ssrn.com/abstract=1480668 or http://dx.doi.org/10.2139/ssrn.1480668.

Lemans, J. (2010). *Goodwill Impairment as a Tool for Earnings Management. Master's thesis: Accounting, Auditing and Control.* Erasmus University Rotterdam.

Lhaopadchan, S. (2010). Fair value accounting and intangible assets Goodwill impairment and managerial choice. *Journal of Financial Regulation and Compliance, 18*, 120-130.

Massoud, M.F., & Raiborn C.A (2003). Accounting for Goodwill: Are We Better Off? *Review of Business, 24,* 26-32.

Onesti, T., & Romano, M. (2012). Earnings Management and Goodwill Accounting: Implications on Dividend Policy in Italian Listed Companies. Available at SSRN: http://ssrn.com/abstract=2179159

Ramanna, K., & Watts, R. L. (2008). *Evidence from Goodwill Non-impairments on the effects of Unverifiable Fair value accounting*. Harvard Business School Accounting and Management Unit. Working paper.

Ramanna, K., & Watts, R. L. (2011). Evidence on the use of unverifiable estimates in required goodwill impairment. *Review of Accounting Studies, 17) Harvard Business School Accounting & Management Unit Working Paper. 09-106*. Available at SSRN: http://ssrn.com/abstract=1134943

Saastamoinen, J., & Pajunen, K. (2012). Goodwill Impairment Losses as Managerial Choices. Available at SSRN: http://ssrn.com/abstract=2000690

Van de Poel, K., Maijorr, S., & Vanstraelen, A. (2009). IFRS goodwill impairment test and earnings management: the influence of audit quality and the institutional environment. Available at: http://www.researchgate.net.

Vichitsarawong, T. (2007). *The Usefulness of Goodwill Impairment Under SFAS No. 142 in reflecting the relative efficienty of firms*. Doctoral disertation: accounting. Oklahoma State University.

Wines, G., Dagwell, R., & Windsor, C., (2007). Implications of the IFRS goodwill accounting treatment. *Managerial Auditing Journal, 22,* 862-880.

Zang Y. (2008). Discretionary behavior with respect to the adoption of SFAS no. 142 and the behavior of security prices. *Review of Accounting and Finance, 7,* 38-68.